

AMENDED IN SENATE APRIL 24, 2003

**SENATE BILL**

**No. 1067**

**Introduced by ~~Committee on Revenue and Taxation (Senators Cedillo (Chair), Alpert, Bowen, and Burton)~~ Senator Speier**

February 27, 2003

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~~An act to amend Sections 2205 and 5008.6 of the Corporations Code, relating to corporations. An act to add Section 25115 to the Revenue and Taxation Code, relating to taxation, to take effect immediately, tax levy.~~

LEGISLATIVE COUNSEL'S DIGEST

SB 1067, as amended, ~~Committee on Revenue and Taxation Speier. Filings: suspension penalty Corporation taxes: water's-edge election.~~

~~Existing law requires a corporation to file specified information with the Secretary of State. Under existing law, the powers, rights, and privileges of a corporation may be suspended if it fails to file this information and other designated circumstances exist.~~

~~This bill would make nonsubstantive changes to these provisions.~~

*The Corporation Tax Law imposes taxes measured by income and, in the case of a business with income derived from or attributable to sources both within and without this state, apportions the income between this state and other states and foreign countries in accordance with a specified 4-factor formula based on the property, payroll, and sales within and without this state, except as otherwise provided. That law allows corporations to elect whether their income is determined on a "water's-edge" basis or on a worldwide unitary basis. The election to report income on a water's-edge basis is made by contract between the taxpayer and the Franchise Tax Board. In general, a corporation*

that makes a water's-edge election is subject to tax on income only from sources within the United States.

This bill would prohibit any foreign incorporated entity that is treated as an inverted domestic corporation, as specified, from making a water's-edge election, as provided.

This bill would result in a change in state taxes for the purpose of increasing state revenues within the meaning of Section 3 of Article XII A of the California Constitution, and thus would require for passage the approval of  $\frac{2}{3}$  of the membership of each house of the Legislature.

This bill would take effect immediately as a tax levy.

Vote: ~~majority~~  $\frac{2}{3}$ . Appropriation: no. Fiscal committee: ~~no~~ yes. State-mandated local program: no.

*The people of the State of California do enact as follows:*

- 1    ~~SECTION 1. Section 2205 of the Corporations Code is~~  
2    *SECTION 1. Section 25115 is added to the Revenue and*  
3    *Taxation Code, to read:*  
4    *25115. (a) Any foreign incorporated entity that is treated as*  
5    *an inverted domestic corporation under subdivision (b) may not*  
6    *make a water's edge election under this article.*  
7    *(b) For purposes of this section, a foreign incorporated entity*  
8    *shall be treated as an inverted domestic corporation if, pursuant*  
9    *to a plan (or a series of related transactions), all of the following*  
10   *apply:*  
11    *(1) The entity completes on or after January 1, 2003, the direct*  
12   *or indirect acquisition of substantially all of the properties held*  
13   *directly or indirectly by a domestic corporation or substantially all*  
14   *of the properties constituting a trade or business of a domestic*  
15   *partnership.*  
16    *(2) After the acquisition described in paragraph (1), at least 80*  
17   *percent of the stock (by vote or value) of the entity is held by either*  
18   *of the following:*  
19    *(A) In the case of an acquisition with respect to a domestic*  
20   *corporation, by former shareholders of the domestic corporation*  
21   *by reason of holding stock in the domestic corporation.*  
22    *(B) In the case of an acquisition with respect to a domestic*  
23   *partnership, by former partners of the domestic partnership by*  
24   *reason of holding a capital or profits interest in the domestic*  
25   *partnership.*

1     (3) *The expanded affiliated group that, after the acquisition*  
2 *described in paragraph (1), includes the acquired entity does not*  
3 *have substantial business activities in the foreign country in which,*  
4 *or under the law of which, the entity is created or organized when*  
5 *compared to the total business activities of that expanded affiliated*  
6 *group.*

7     (c) (1) *In applying subdivision (b), the following rules apply:*

8     (A) *There shall not be taken into account in determining*  
9 *ownership, for purposes of paragraph (2) of subdivision (b), either*  
10 *of the following:*

11     (i) *Stock held by members of the expanded affiliated group that*  
12 *includes the foreign incorporated entity.*

13     (ii) *Stock of that entity that is sold in a public offering related*  
14 *to the acquisition described in paragraph (1) of subdivision (b).*

15     (B) *If a foreign incorporated entity acquires, directly or*  
16 *indirectly, substantially all of the properties of a domestic*  
17 *corporation or partnership during the four-year period beginning*  
18 *on January 1, 2003, and the ownership requirements of paragraph*  
19 *(2) of subdivision (b) are met within two years from the date of that*  
20 *acquisition, then, that acquisition shall be treated as having been*  
21 *made pursuant to a plan.*

22     (C) *The transfer of properties or liabilities (including by*  
23 *contribution or distribution) shall be disregarded if the transfers*  
24 *are part of a plan, a principal purpose of which is to avoid the*  
25 *purposes of this section.*

26     (D) *For purposes of applying subdivision (b) to the acquisition*  
27 *of a domestic partnership, all domestic partnerships that are under*  
28 *common control (within the meaning of Section 482 of the Internal*  
29 *Revenue Code) shall, except as otherwise provided in regulation,*  
30 *be treated as a partnership.*

31     (E) *The franchise shall prescribe those regulations as may be*  
32 *necessary to do both of the following:*

33     (i) *Treat warrants, options, contracts to acquire stock,*  
34 *convertible debt instruments, and other similar interest as stock.*

35     (ii) *Treat stock as not stock.*

36     (2) *The term “expanded affiliated group” means an affiliated*  
37 *group as defined in Section 1504(a) of the Internal Revenue Code*  
38 *(without regard to Section 1504(b) of that Code), except that*  
39 *Section 1504 of that Code shall be applied by substituting more*  
40 *than 50 percent for “at least 80 percent” each place it appears.*

1 (3) The term “foreign incorporated entity” means any entity  
2 that is, or but for subdivision (b) would be, treated as a foreign  
3 corporation for purposes of the Internal Revenue Code.

4 (4) The terms “person,” “domestic,” and “foreign” have the  
5 meanings given those terms by paragraphs (1), (4), and (5) of  
6 Section 7701(a) of the Internal Revenue Code, respectively.

7 (d) The Franchise Tax Board shall waive subdivision (a) with  
8 respect to any specific contract if the Franchise Tax Board  
9 determines that the waiver is required in the interest of homeland  
10 security, or to prevent the loss of any jobs in California or prevent  
11 the state from incurring any additional costs that otherwise would  
12 not occur.

13 (e) This section applies only to water’s-edge elections,  
14 including extensions, made on or after January 1, 2003, and does  
15 not affect any contracts in existence prior to that date.

16 SEC. 2. This act provides for a tax levy within the meaning of  
17 Article IV of the Constitution and shall go into immediate effect.  
18 ~~amended to read:~~

19 ~~2205.—(a) A corporation is subject to suspension pursuant to~~  
20 ~~this section rather than to assessment of a penalty pursuant to~~  
21 ~~Section 2204 if all of the following circumstances exist:~~

22 ~~(1) The corporation failed to file a statement pursuant to~~  
23 ~~Section 1502 for an applicable filing period.~~

24 ~~(2) The corporation has not filed a statement pursuant to~~  
25 ~~Section 1502 during the preceding 24 months.~~

26 ~~(3) The corporation was certified for a penalty pursuant to~~  
27 ~~Section 2204 for the same filing period.~~

28 ~~(b) If subdivision (a) is applicable, the Secretary of State shall~~  
29 ~~mail a notice to the corporation informing the corporation that its~~  
30 ~~corporate powers, rights, and privileges will be suspended after 60~~  
31 ~~days if it fails to file a statement pursuant to Section 1502.~~

32 ~~(c) After the expiration of the 60-day period without any~~  
33 ~~statement filed pursuant to Section 1502, the Secretary of State~~  
34 ~~shall notify the Franchise Tax Board of the suspension, and mail~~  
35 ~~a notice of the suspension to the corporation and thereupon, except~~  
36 ~~for amending the articles of incorporation to set forth a new name,~~  
37 ~~the corporate powers, rights, and privileges of the corporation are~~  
38 ~~suspended.~~

39 ~~(d) A statement pursuant to Section 1502 may be filed~~  
40 ~~notwithstanding suspension of the corporate powers, rights, and~~

1 ~~privileges pursuant to this section or Section 23301 or 23301.5 of~~  
2 ~~the Revenue and Taxation Code. Upon the filing of a statement~~  
3 ~~pursuant to Section 1502 by a corporation that has suffered~~  
4 ~~suspension pursuant to this section, the Secretary of State shall~~  
5 ~~certify that fact to the Franchise Tax Board, and the corporation~~  
6 ~~may thereupon be relieved from suspension unless the corporation~~  
7 ~~is held in suspension by the Franchise Tax Board by reason of~~  
8 ~~Section 23301 or, 23301.5 of the Revenue and Taxation Code.~~

9 ~~SEC. 2. Section 5008.6 of the Corporations Code is amended~~  
10 ~~to read:~~

11 ~~5008.6. (a) A corporation is subject to suspension pursuant to~~  
12 ~~this section rather than to assessment of a penalty under Section~~  
13 ~~6810 or 8810 if all of the following circumstances exist:~~

14 ~~(1) The corporation failed to file a statement pursuant to~~  
15 ~~Section 6210, 8210, or 9660 for an applicable filing period.~~

16 ~~(2) The corporation has not filed a statement pursuant to~~  
17 ~~Section 6210, 8210, or 9660 during the preceeding 24 months.~~

18 ~~(3) The corporation was certified for a penalty pursuant to~~  
19 ~~Section 6810, 8810, or 9690 for the same filing period.~~

20 ~~(b) If subdivision (a) is applicable, the Secretary of State shall~~  
21 ~~mail a notice to the corporation informing the corporation that its~~  
22 ~~corporate powers, rights, and privileges will be suspended 60 days~~  
23 ~~from the date of the notice if the corporation does not file the~~  
24 ~~statement required by Section 6210, 8210, or 9660.~~

25 ~~(c) If the 60-day period expires without the delinquent~~  
26 ~~corporation filing the required statement, the Secretary of State~~  
27 ~~shall notify the Franchise Tax Board of the suspension, and mail~~  
28 ~~a notice of the suspension to the corporation. Thereupon, except~~  
29 ~~for filing an application for exempt status or amending the articles~~  
30 ~~of incorporation to set forth a new name, the corporate powers,~~  
31 ~~rights, and privileges of the corporation are suspended.~~

32 ~~(d) A statement required by Section 6210, 8210, or 9660 may~~  
33 ~~be filed, notwithstanding suspension of the corporate powers,~~  
34 ~~rights, and privileges under this section or under provisions of the~~  
35 ~~Revenue and Taxation Code. Upon the filing of a statement under~~  
36 ~~Section 6210, 8210, or 9660, by a corporation that has suffered~~  
37 ~~suspension under this section, the Secretary of State shall certify~~  
38 ~~that fact to the Franchise Tax Board, and the corporation may~~  
39 ~~thereupon be relieved from suspension, unless the corporation is~~

- 1 ~~held in suspension by the Franchise Tax Board because of Section~~
- 2 ~~23301, 23301.5, or 23775 of the Revenue and Taxation Code.~~

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